

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

New England Power Company)

Docket No. ER97-678-000

EXPLANATORY STATEMENT

This Explanatory Statement is submitted in support of the Stipulation and Agreement ("Agreement") among New England Power Company ("NEP"), the Office of the Attorney General of Massachusetts ("Attorney General"), Massachusetts Electric Company and Nantucket Electric Company (referred to collectively as "Mass. Electric"), the Massachusetts Division of Energy Resources, Conservation Law Foundation, American National Power, American Tractebel Corporation, KCS Power Marketing, Inc., Low Income Intervenors (Irving Bernstein and Pearl Noorigian, represented by National Consumer Law Center), Massachusetts Community Action Directors Association, Massachusetts Energy Directors Association, Massachusetts High Technology Council, Northeast Energy and Commerce Association, Northeast Energy Efficiency Council, Inc., The Energy Consortium, Union of Concerned Scientists, and U.S. Generating Company (each of the foregoing entities being referred to as a "Signatory" to the Agreement).^{1/}

^{1/}The Agreement as initially executed by the Signatories was approved by the Department of Public Utilities in an order dated February 26, 1997 in Docket D.P.U. 96-25. Not all of the original Signatories have intervened in this proceeding or have participated in the negotiations leading to this Settlement. The revised Agreement as filed today is executed by the Attorney General, the Massachusetts Division of Energy Resources, Mass. Electric, and NEP. The Settlement as revised is being circulated for comment to the Signatories and other participants in the Department's proceeding on the Settlement. The Department will issue a further order on the changes following the receipt of comments.

If accepted by the Commission, the Agreement would specify the conditions for the termination of the wholesale electric requirements contract between NEP and its affiliate, Mass. Electric. Currently, NEP supplies all of Mass. Electric's requirements for electricity to supply retail customers in Mass. Electric's service territory pursuant to a service agreement under NEP's Primary Service for Resale Tariff (NEP's FERC Electric Tariff, Original Volume No. 1, or "Tariff No. 1"). Under Tariff No. 1, either party must give seven years' advance notice before terminating service.

The Agreement provides for the termination of Mass. Electric's wholesale purchases under its Tariff No. 1 service agreement earlier, in order to accommodate the introduction of retail choice for customers of Mass. Electric and the introduction of expanded competition in wholesale electric supplies. The Agreement thus implements both the policies of the Massachusetts Department of Public Utilities ("Department") in favor of retail competition and the policies of this Commission, as articulated in Order No. 888 and 888-A, in favor of wholesale competition. The Agreement also marks an important milestone in the restructuring of the electric utility industry in New England; it is a critical step for the introduction of retail choice for electric service in Massachusetts. Because of the structure of the NEES system, of which NEP and Mass. Electric are subsidiaries, the Agreement presents a unique circumstance, under which the Commission must approve the voluntary termination of wholesale requirements service in order to enable a State-sponsored retail competition program to go forward. As such, it implicates important State interests and is consistent with Commission's policy of "cooperative federalism," under which it strikes an appropriate balance between Federal and State interests.

Finally, the Agreement is part of an overall settlement that also resolves proceedings before the Department concerning the introduction of retail choice. The retail aspects of the settlement were approved by the Department on February 26, 1997. Approval of the Agreement will therefore enable NEP and Mass. Electric to terminate their wholesale requirements relationship on terms that the Department has endorsed at the retail level.

The principal components of the Agreement, all of which are interdependent, are as follows:

1. The Signatories agree that it is just, reasonable, and consistent with the public interest to terminate the obligations of NEP and Mass. Electric under their Tariff No. 1 wholesale requirements service agreement in accordance with the provisions of an amendment to that service agreement ("Amendment") which is appended to the Agreement. Major provisions of the Amendment include the following:

(a) The Amendment allows Mass. Electric to terminate its purchase of wholesale requirements service from NEP on or after January 1, 1998 either: (i) upon 90 days' notice to NEP, rather than seven years' notice, or (ii) upon the introduction of retail access for customers of investor-owned electric utilities in Massachusetts.

(b) The Amendment requires Mass. Electric to pay Contract Termination Charges to NEP, commencing with the termination of its requirements purchase obligation, to enable NEP to recover an allocable share of the costs it has incurred to provide requirements service to Tariff No. 1 customers, including Mass. Electric.

These costs, which are specified in a formula included as part of the Amendment, include costs associated with NEP's investments in generating assets, NEP's contractual commitments for purchased power and fuel transportation, deferred costs and other regulatory assets, nuclear post-shutdown costs including decommissioning costs, and employee severance and retraining costs, together with a return on unrecovered costs. The Agreement includes a mechanism for resolving any disputes that may arise in the implementation of the Contract Termination Charge formula.

(c)The Amendment requires NEP to credit against Mass. Electric's responsibility for Contract Termination Charges a proportionate share of the remaining value of NEP's generating business. As described below, NEP has agreed as part of the Agreement and the retail settlement approved by the Department to divest its generating business. Through the residual value credit and the proposed divestiture, Mass. Electric's allocable share of the remaining value of NEP's generating assets, as determined by the market, will be passed on to Mass. Electric, rather than being retained by NEP's shareholders.

(d)The Amendment requires NEP to provide wholesale "Standard Offer Service" to Mass. Electric after the termination of the Tariff No. 1 purchase obligation, at a fixed schedule of prices (subject to adjustment only for a fuel index) to enable Mass. Electric to meet its obligations to provide continued

service to its retail customers who do not immediately turn to the market for retail power supplies. The schedule of prices for wholesale Standard Offer Service is designed to enable those customers to realize savings as a result of the restructuring of the contractual relationship between Mass. Electric and NEP. While NEP is obligated to supply wholesale Standard Offer Service to Mass. Electric, Mass. Electric is not obligated to purchase that wholesale power from NEP after the date when retail customers are allowed to choose their suppliers. Rather, the Agreement and the Amendment recognize that Mass. Electric will afford other suppliers the opportunity to bid to supply the power it needs to meet its retail Standard Offer obligations after the retail access date. In this manner, the Agreement provides enhanced opportunities for wholesale competition in conjunction with the introduction of retail competition in Massachusetts and, through NEP's obligation to supply wholesale power at a fixed stream of prices, provides a high level of assurance that all Mass. Electric customers will have an opportunity to benefit from the introduction of competition at wholesale and at retail .

(e) Pending the termination of NEP's Tariff No. 1 wholesale requirements service to Mass. Electric, current base rates for that service are frozen until January 1, 2001, except that NEP agrees to refund to Mass. Electric a proportionate share of earnings that produce a return on common equity above 11.75

percent per year, for the period prior to the Retail Access Date or the Contract Termination Date following divestiture as set forth in the Agreement at note 4.

(f) NEP commits to provide unbundled network transmission service to Mass.

Electric after the termination of bundled requirements service in accordance with the Amendment.

2. The Agreement also reflects NEP's agreement to divest its generation business. NEP has committed to divest its fossil-fuel and hydroelectric generation units, as well as its investments in oil and gas properties, its contractual entitlements to purchase power from third parties and for natural gas pipeline capacity, and generating units owned by affiliates that are controlled and paid for by NEP pursuant to the integrated facilities provisions of Tariff No. 1. NEP has also agreed to attempt to divest its minority interests in certain nuclear generating units. A proportionate share of the net proceeds received by NEP through the divestiture will be credited against Mass. Electric's obligation to pay Contract Termination Charges. NEP commits to file a plan to implement divestiture with the Commission by October 1, 1997 and to complete divestiture by six months after the introduction of retail access for customers of Mass. Electric or the receipt of all necessary governmental approvals. The Commission's acceptance or approval of the Agreement is not intended to constitute any approvals required for the divestiture under section 203 or, with respect to NEP's hydroelectric facilities, Part I of the Federal Power Act. Rather, the

Agreement acknowledges that NEP will submit any necessary applications to the Commission at a later date.

(a)The Agreement provides that if NEP retains the obligation to pay post-shutdown, decommissioning, or site restoration costs for its interests in nuclear generating plants as part of the disposition of those interests, NEP will be entitled to recover a proportionate share of those costs from Mass. Electric in the Contract Termination Charges. In the event NEP is unable to dispose of its interests in nuclear generating plants, NEP will be entitled to recover 80 percent of the reasonable going forward costs of operating the plants through the Contract Termination Charges and will credit 80 percent of the revenues from the kilowatthour sales from its interests in the plants to the calculation of the Contract Termination Charges. NEP also agrees to present a proposed performance standard applicable to its nuclear plant interests and to support adoption at those plants of a detailed procedure to be implemented in the event it is decided to shut down any of those plants prematurely.

(b)The Agreement provides that NEP may recover in Contract Termination Charges to Mass. Electric a proportionate share of the payments to power suppliers and other costs associated with buying out of or buying down purchased power contracts. In the event NEP is unable to dispose of its rights under those contracts, the Agreement contemplates that NEP will sell the

power purchased under those contracts. Both the contract payments and the revenues received from the sale of that power in the market will be reflected in the Contract Termination Charges. NEP may, however, use its rights under those contracts to fulfill its minimum obligations to supply wholesale Standard Offer Service to Mass. Electric.

3.The Agreement requires NEP to reduce emissions of NO_x and SO₂ from certain generating units by the amounts and on the schedule specified in an attachment to the Agreement. This requirement will also apply to the party or parties that acquire those generating units upon NEP's divestiture of them.

4.The Agreement also reflects the Signatories' agreement on the following issues:

(a)The Signatories agree that market pricing is appropriate for sales at wholesale from NEP's generation.

(b)The Signatories agree to the appropriateness of the designation of NEP's generating units as eligible facilities under section 32 of the Public Utility Holding Company Act.

(c)The Signatories agree that all of the facilities of NEP and Mass. Electric used for the delivery of electricity to retail customers, except for those facilities that are financially supported by NEP pursuant to the integrated facilities provision of NEP's Tariff No. 1, are appropriately classified as distribution facilities subject to the ratemaking jurisdiction of the Department.

The Agreement specifies that the Commission's acceptance or approval of the Signatories' agreements on the above issues is not a condition of the Commission's acceptance of the Agreement in resolution of this proceeding.

5. The Agreement recognizes that NEP is making substantial and irreversible commitments, including the divestiture of its generating business and the assignment of Mass. Electric's share of the residual value of its generating assets for the benefit of Mass. Electric and its customers, primarily in consideration for an entitlement to the recovery of Contract Termination Charges from Mass. Electric, determined in accordance with the Amendment, over an extended period of time. To give effect to NEP's reliance on the bargain reflected in the Agreement and the Amendment, the Signatories seek the Commission's assurance that it will, to the fullest extent permissible under the Federal Power Act, give effect to NEP's right to charge and recover Contract Termination Charges from Mass. Electric in accordance with the Amendment. The Agreement specifically precludes application to the Commission for changes to the Contract Termination Charge formula, under either section 205 or section 206 of the Federal Power Act, absent NEP's agreement (section 3.6) and calls upon the Commission to refrain from revisiting the issue of the justness and reasonableness of the Contract Termination Charges or from limiting NEP's right to recover in full the Contract Termination Charges contemplated by the Agreement (section 6.1).

NEP recognizes that the Commission's responsibility to order changes in jurisdictional rates that are contrary to the public interest cannot be precluded by a settlement agreement. See El Paso Electric Co., 43 FERC ¶ 61,201 (1988). The Signatories have concluded that, taken as whole, the provisions of the Agreement, including NEP's recovery of the Contract Termination Charges in full, are just, reasonable, and consistent with the public interest. It is noteworthy that the Signatories reaching that conclusion include the Attorney General, who is authorized by Massachusetts law to represent the interests of Mass. Electric's retail customers in proceedings before this Commission. See Mass. Gen. Laws, c. 12, sec. 11E. The Signatories have also recognized that the Agreement goes beyond the resolution of a single wholesale rate proceeding. Rather, it provides the terms for the fundamental restructuring of the contractual relationship between NEP and Mass. Electric and commits NEP to divest its generating business. In light of the gravity and the irreversible nature of the mutual commitments reflected in the Agreement, the Signatories seek to assure the continued vitality of those commitments to the greatest extent possible consistent with the Commission's exercise of its statutory authority. As other regulatory agencies have done when they have approved similarly long-lived settlements, see Pacific Gas & Electric Co., 99 P.U.R. 4th 141 (Cal. Publ. Util. Com'n 1988), the Commission should indicate that it recognizes the unusual nature of the commitments in the Agreement and will

not disturb them absent an unequivocal showing that the public interest cannot be served in any other way.

6. The Agreement does not affect Tariff No. 1 customers other than Mass.

Electric: The Amendment modifies the Tariff No. 1 service agreement between NEP and Mass. Electric, not Tariff No. 1 itself.

Indeed, the Agreement modifies Tariff No. 1 only to add a Statement to ensure that the termination of Mass. Electric's Tariff No. 1 service will not cause NEP's fuel charges to other Tariff No. 1 customers to increase. NEP will continue to provide wholesale requirements service under Tariff No. 1 to current customers who choose not to terminate that service.

Respectfully submitted,

Edward Berlin
Kenneth G. Jaffe
Richard P. Sparling
SWIDLER & BERLIN, CHARTERED
3000 K Street, N.W., Suite 300
Washington, D.C. 20007
(202) 424-7500

Thomas G. Robinson
NEW ENGLAND POWER SERVICE
COMPANY
25 Research Drive
Westborough, MA 01582
(508) 389-2877

Counsel for New England Power
Company